



March 9, 2004

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave., N.W.
Washington, DC 20551

COMMENTS ON PROPOSED RULE IMPLEMENTING
THE CHECK 21 ACT
Docket #R-1176

By hard copy and electronic mail to regs.comments@federalreserve.gov

The Federal Reserve has issued a proposed rule and commentary that does a commendable job interpreting a difficult statute. Especially helpful are the examples that illustrate how the Act applies to specific situations. The rule and commentary should be improved, however, in the following ways.

The FRB should be guided by Congress' intention to ensure that consumers would be protected from wrongful debits that occur as a result of the use of substitute checks. Put another way, Congress did not intend for consumers to be worse off as a result of the electronic imaging that Check 21 facilitates. When the Act is subject to various interpretations, the rule should clearly establish requirements to promote consumer protection. This is because a wrongful debit or multiple debits, can have a devastating effect on most consumers. They can drain funds from the consumer's account, making it impossible to pay the rent or make a car payment and resulting in late fees, NSF charges, a bad credit rating, etc. Congress knew this and therefore included the recredit right.

Unfortunately, it is not clear what is required for consumers to be entitled to this right. Nowhere does the Act specifically say that this crucial right is available only if the consumer was provided a substitute check. But section 7(a) states that a consumer may make a claim for a recredit, inter alia, if the consumer asserts that her bank charged her account for "a substitute check that was provided to the consumer." Other parts of section 7, however, describe in great detail what is required for a consumer to perfect a right to a recredit, repeating some of what is in

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section 7(a), but never even hinting that a substitute check must have been provided. If this language is meant to deprive consumers of a crucial right, it is a backhanded and confusing way to do so. The FRB's commentary adopts the narrowest construction of this language, requiring that a substitute check has been "received" rather than provided, and suggesting even receipt of an image of a substitute check would not be sufficient. Not only is this contrary to Congress' general intention to provide consumers the recredit right, it is contrary to the "provided" language in the statute. The resolution most consistent with Congress' intent would be to require financial institutions to provide substitute checks whenever a consumer claims a wrongful debit in a transaction in which there is a dispute implicating a substitute check. At the least, the final rule should make it clear that being provided an image of a substitute check is sufficient to satisfy the "provided" requirement.

It seems clear from the commentary the FRB expects that if a consumer requests a substitute check, the financial institution will provide it, whether or not the consumer has agreed to truncation. The final rule should state this as an explicit requirement. Otherwise, financial institutions can evade the Act simply by refusing to provide substitute checks when consumers request them.

Most consumers will not know that without the substitute check, the consumer may not be entitled to the recredit or indemnity rights. Therefore, the rules should require the financial institution to provide a substitute check even if the consumer has requested the original check or a copy of the original. Providing the substitute check triggers the requirement to send the consumer awareness notice, essential information for the consumer to have if the Act is to fulfill its objectives.

In addition, financial institutions should provide all its new and existing consumer customers with the consumer awareness notice, not just those who, pursuant to section 12(b), receive original checks or substitute checks. This will ensure that all consumers subject to possible wrongful debits due to substitute checks have equal knowledge of their rights. In the words of section 15 (authorizing the Board to issue regulations), such a rule is necessary to implement the Act. Otherwise, financial institutions can circumvent or evade compliance with the Act as to those consumers who do not receive the notice and therefore do not know what their rights are.

Notice to all consumers is especially important given the confusing world consumers have to navigate. When they give a merchant a check, the merchant may process the check the traditional way, subject to the UCC rules. The merchant may instead use the check as a source document, engaging in electronic check conversion, subject to the EFTA, Reg. E, and the NACHA Rules. Soon, the merchant will have the alternative of processing the check using

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electronic images and substitute checks. All of these transactions (as well as debit card payments, ATM deposits and withdrawals, direct deposit, and preauthorized drafts and electronic transfers) appear on the consumer's monthly statement in various places and under various category headings. Somehow consumers are expected to navigate through this bewildering maze and comply with the different reporting rules of each statute in order to take advantage of the protections provided by these laws. In light of this confusing and constantly changing new world, all consumers need the consumer awareness notice. The rule should require that they receive it.

Incorporating the above into the final rule will help to ensure that consumers will not be unduly disadvantaged by Check 21. It also will make Check 21's implementation consistent with Congress' intention.

Sincerely,

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